LAPO Microfinance Bank Limited

Final Rating Report

Agusto&Co.

Research, Credit Ratings, Credit Risk Management

LAPO Microfinance Bank Limited

Rating:

A-

Outlook: Stable
Issue Date: 2 February 2018
Expiry Date: 30 June 2018
Previous Rating: A-

Industry:
Microfinance

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Rating Rationale

LAPO Microfinance Bank's ("LAPO" or "the Bank") rating reflects the Bank's strong market position, good capitalisation and profitability as well as a stable & experienced management team. Agusto & Co. also considers the Bank's good business strategy, which has enabled significant growth through branch expansion and product diversification. The rating assigned to LAPO is constrained by the rising level of impaired loans and the macroeconomic climate, which continues to adversely affect small businesses.

With total assets of ₦62.7 billion as at 31 December 2016, LAPO Microfinance Bank is the largest microfinance bank operating in Nigeria. The Bank's loan portfolio has grown by over 50% in the last three years. However, asset quality deteriorated in 2016, with portfolio-at-risk (PAR) to total loans of 5.8% as at FYE 2016 – higher than the regulatory threshold of 5%. The increase reflects the heightened credit risks in key sectors such as trade, commerce and agriculture. Loan loss provision coverage remained adequate at 82% as FYE2016 (2015: 72%). Based on the unaudited financials for the nine months ended 30 September 2017, PAR to gross loans spiked to 7.9%. We believe this may rise further in the near term, given increasing pressures from the aforementioned sectors. We believe that better risk management processes will be required to forestall additional increases in impaired loans.

During FY 2016, net earnings increased by 24% to ₦23.1 billion, largely on account of the 15% growth in LAPO's loan portfolio. Successively, profitability indicators inched up, with pre-tax return on average assets (ROA) and pre-tax return on average equity (ROE) at 11.7% and 56.3% respectively, from 10.6% and 53.5% in the prior year. The Bank's cost-to-income ratio (CIR) improved marginally to 71.5% (2015: 72.5%) - which compares favourably with industry standards and our benchmarks. The Bank's CIR worsened to 74.8% during the nine months ended 30 September 2017. Subsequently, profitability declined, with annualised pre-tax ROA and ROE of 9.8% and 43.1% respectively. We believe this will dip further in the near term, on account of rising costs emanating from business expansion and the increasing level of impaired loans. Nonetheless, we believe profitability will remain good by industry standards.

LAPO remains well capitalised for its current business risks, with shareholders' funds growing by 25% to ₦13.6 billion as at 31 December 2016. The Bank's capital adequacy ratio also stood at 38.6% as at the same date (2015: 24.2%) - significantly higher than the regulatory minimum of 10% for microfinance banks.

The Bank enjoys relatively stable, low-cost deposits as well as a growing pool of tenured deposits. LAPO also has access to financing from a number of local and foreign financial institutions including Development Finance Institutions (DFIs). These borrowings provide adequate support to the Bank's asset and liability management. In an effort to reduce exposure to foreign exchange risk, LAPO intends to diversify its funding base by accessing the domestic debt market. The Bank plans to issue a local currency bond in the first half of 2018, which will be the second series of its ₦20 billion debt issuance programme.

Agusto & Co. also notes LAPO's good liquidity position, with liquid assets accounting for 35.2% of total deposit liabilities - which is higher than the 20% regulatory minimum for microfinance banks.

Based on the aforementioned, we hereby assign an "**A-**" rating to LAPO Microfinance Bank Limited.

Strengths

- Strong market position
- Good profitability
- Good capitalisation
- Experienced and stable management team

Weakness

- Rising levels of impaired loans

Challenges

- Efficient loan remediation and keeping operating costs low, given the weak but improving macroeconomic environment
- Reducing foreign currency risk and its resulting impact on operating costs

Table 1: Financial Data

	FY 2016	FY 2015
Total assets & contingents	₦62.7 billion	₦52.4 billion
Total deposit liabilities	₦27.6 billion	₦25.7 billion
Net earnings	₦23.1 billion	₦17.7 billion
Pre-tax return on average assets	11.7%	10.6%
Pre-tax return on average equity	56.3%	53.5%

PROFILE

LAPO Microfinance Bank Limited ("LAPO" or "the Bank") was registered as a private limited liability company in 2007 and licensed by the Central Bank of Nigeria (CBN) to operate as a microfinance bank in June 2010. The Bank commenced operations in 1987 as an offspring of Lift Above Poverty Organisation (LAPO), a non-governmental and non-profit community development organisation. In September 2010, LAPO obtained a national microfinance licence from the CBN, and is one of the eight National Microfinance Banks in Nigeria. LAPO provides microfinance loans to micro-enterprises and low-income households, with an emphasis on women. In addition to providing loans to low-income households, the Bank also provides financial services to small and medium scale enterprises (SMEs) and key sectors such as agriculture, housing and renewable energy.

The equity of LAPO Microfinance Bank is closely held by two shareholders - LAPO NGO, which controls a 67.10% equity stake and Dr. Godwin Ehigiamusoe with 30.1%. LAPO Microfinance Bank has a nine-member Board of Directors, which includes three executive directors and six non-executive directors, inclusive of one independent director. LAPO appointed the independent director, Mrs. Hannatu Yaro, in 2016. Mr. Osarenren Emokpae is the Chairman of the Board, while Dr. Godwin Ehigiamusoe serves as the Bank's Managing Director/Chief Executive Officer.

Table 2: List of Directors & Shareholding Structure

Current Directors	**Position**	**Shareholding %**
Dr. Osarenren Emokpae	*Chairman*	0.60%
Dr. Godwin Ehigiamusoe	*Managing Director/Chief Executive Officer*	30.10%
Mrs. Hannatu Yaro Ahmed	*Non-Executive Director (Independent)*	Nil
Mrs. Osaretin Demuren	*Non-Executive Director*	0.60%
Mr. Ede Osayande	*Non-Executive Director*	0.60%
Mr. Andrew Ejoh	*Non-Executive Director*	0.45%
Mr. Rene Azokly	*Non-Executive Director*	0.55%
Ms. Josephine Nwachukwu	*Executive Director*	Nil
Mrs. Faith Osazuwa-Ojo	*Executive Director*	Nil
Significant Shareholder(s)		**Shareholding %**
Life Above Poverty Organisation (LAPO)		67.10%

The Bank's head office is situated at LAPO Place, 18 Dawson Road, Benin City. LAPO's branch network increased significantly from 386 branches in the prior year to 462 branches in 2017. These branches are spread across twenty eight states in Nigeria. During the year ended 31 December 2016, LAPO had an average staff strength of 6,392 persons.

Business Structure

LAPO Microfinance Bank's operations are structured along seven core departments which are: Legal & Compliance, Risk Management, Corporate Planning & Strategy, Finance & Accounts, Corporate Services, Operations & IT and Internal Audit. The heads of the core units report to the Managing Director while the head of Internal Audit reports directly to the Board Audit Committee and to the Managing Director for administrative matters.

Correspondent Banks

LAPO Microfinance Bank Limited maintains relationship with the following Nigerian banks:

- United Bank for Africa (UBA)
- Standard Chartered Bank Nigeria Limited
- Zenith Bank Plc.
- Access Bank Plc.
- First Bank of Nigeria Limited

None of these banks had equity stake in the Bank as at 31 December 2016.

Information Technology

LAPO Microfinance Bank Limited uses the Orbit-R banking application for its core operations. Orbit-R is centralised and used across all LAPO branches. The application also aids general ledger entries, transaction and risk management reporting & other banking operations. The application is connected at all branches through an HP Generation 9 (Gen9) server. The server also provides other branch connectivity functions such as email. The UTNET application used for agent banking transactions, was launched in 2016. The application currently serves over two hundred agent bankers. The Bank also adopted a credit appraisal module for loan evaluations. LAPO Microfinance Bank maintains an off-site data recovery site and carries out daily back-ups at all LAPO branches.

Business Strategy

LAPO Microfinance Bank recently concluded its five-year strategy which was formulated in 2013. The Bank believes the five-year strategy has brought about improved business performance and a better quality talent pool. Following the conclusion of the five-year strategy, the Bank has adopted a new five-year strategy, with a focus on exploiting new markets (particularly semi-urban and rural areas), maintaining leadership in the Nigerian microfinance industry as well as enhancing technology to promote service delivery.

Track Record of Financial Performance

LAPO Microfinance Bank Limited has recorded significant growth in business volumes over the last three years. The Bank's total assets have grown at a compound annual growth rate of 26% over the last three years, with loans and advances growing at about the same rate. LAPO's profitability indicators; pre-tax return on average assets and average equity averaged 11.5% and 56.9% respectively over the three-year period.

Management Team

Dr. Godwin Ehigiamusoe is the Managing Director/ Chief Executive Office of LAPO Microfinance Bank Limited. Dr. Ehigiamusoe has over 30 years' experience as a microfinance professional, establishing the LAPO NGO in 1987. Prior to the creation of the LAPO NGO, Dr. Ehigiamusoe worked with the Edo State Government. He obtained a B.Sc. in Sociology and a master's degree in Sociology of Development from University of Benin, Benin City. He also holds a Ph.D. in Political Science from Ambrose Alli University, Ekpoma and a Diploma in Cooperative Credit and Savings from the Federal Cooperative College, Ibadan. Dr. Ehigiamusoe has attended several professional courses at Harvard Kennedy School, Lagos Business School, IESE Business School and INSEAD Business School.

Other members of LAPO Microfinance Bank's senior management team include:

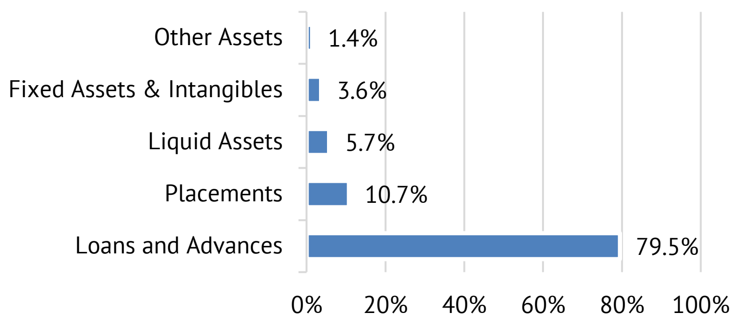
Mrs. Faith Osazuwa-Ojo	*Head, Operations & IT*
Mrs. Josephine Nwachukwu	*Head, Corporate Planning & Strategy*
Mr. Osadebamwen Elijah	*Head, Corporate Services*
Ms. Cynthia Ikponmwosa	*Head, Corporate Secretariat, Legal & Compliance*
Mrs. Gloria Bako	*Head, Risk Management*
Mr. Stanley Oriakhi	*Chief Financial Officer*

ANALYSTS' COMMENTS

ASSET QUALITY

As at 31 December 2016, LAPO Microfinance Bank's total assets had grown by 16% to ₦62.7 billion. The Bank's asset structure remained largely unchanged, with loans and advances remaining the largest asset class, representing 79.5% of total assets as at 2016 financial year end (FYE). Liquid assets comprising cash & equivalents and investments in government securities, accounted for 5.7% of total assets while placements, fixed assets & intangibles as well as other assets accounted for 10.7%, 3.6% and 1.4% respectively.

Figure 1: Breakdown of Total Assets



LAPO's asset creation strategy focuses on providing finance to low-income households & individuals, self-selected groups as well as micro, small & medium enterprises (MSMEs). LAPO's credit products are structured either as individual, group or business related loans. Group loans are granted to a maximum of 40 individuals (group members), where members are joint obligors and co-guarantors.

Gross loans and advances amounted to ₦52.3 billion, a 15% growth from the prior year, as LAPO aggressively pursued business expansion through product diversification. LAPO's loan portfolio primarily consists of micro loans, which accounted for over 80% of the Bank's loan portfolio as at 31 December 2016. Other facilities provided by LAPO include housing loans, SME loans (which target small businesses including small-scale farmers and traders) and other specialised loans focused on the renewable energy sector. SME and housing loans accounted for 7% and 2% of the LAPO's loan portfolio as at the same date. To mitigate possible diversion of funds and defaults, LAPO requires title documents for housing loans, which are verified independently. However, for micro and SME loans, the Bank requires a minimum of two personal guarantors as well as post-dated cheques to cover for future repayments.

LAPO's operations cuts across all of Nigeria's geopolitical zones, albeit skewed towards the South West, which accounted for 45% of LAPO's loan disbursements as at 31 December 2016. The Mid-West, South South and South East accounted for 18%, 12% and 11% respectively. The regions with the lowest loan disbursements as at the same date were the Middle Belt (5%) and the North (8%).

We find that the Bank's loan portfolio concentration in trade and commerce persists, accounting for 90.9% of LAPO's loan portfolio - typical of the Nigerian microfinance industry. In an effort to improve the Bank's outreach, more loans are being disbursed to individuals and businesses involved in agriculture & forestry activities. However, Agusto & Co. does not expect a material change in sector concentration in the near term.

Conversely, the Bank had a well-diversified obligor base, with the top 20 obligors accounting for less than 1% of LAPO's total loans as at FYE 2016.

Figure 2: Loan Portfolio by Geographical Zone

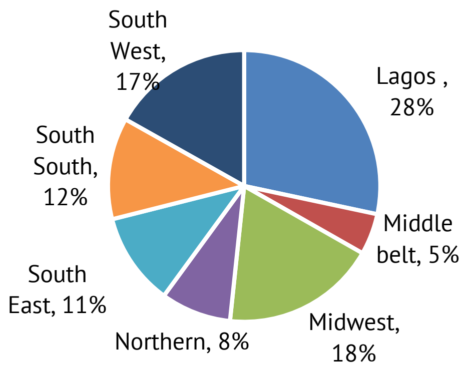
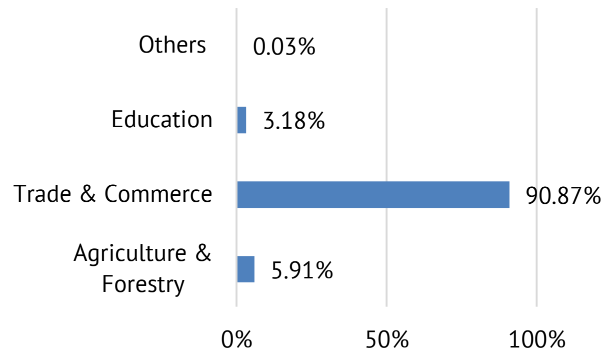


Figure 3: Loan Portfolio by Sector



LAPO's portfolio-at-risk (PAR) increased by 31% to ₦3 billion as at 31 December 2016, translating to a PAR to gross loans ratio of 5.8% (2015: 4.7%). This stood higher than CBN's prescribed maximum threshold of 5% for microfinance banks. LAPO's PAR to gross loans is better than only one of the selected peers – NPF Microfinance Bank Plc. (NPF: 3.2%), Microcred Microfinance Bank Limited (Microcred: 3.6%) and Accion Microfinance Bank Limited (Accion: 18.6%). The Bank's deterioration ratio worsened to 12% as at FYE 2016 (2015: -2%), reflecting the growth in delinquencies outpaced growth in loans. Lost loans - over 91 days past due - accounted for 56% of the Bank's PAR.

The increase in non-performing loans was largely attributable to the rise in defaults from agriculture-related loans. A number of these loans may require moratoriums on repayments due to the seasonal nature of farming, which would ultimately lead to loan losses. The rise in LAPO's impaired loans is also as a result of the significant exposure to the trade and commerce industry, which is typically susceptible to losses in periods of weak macroeconomic fundamentals.

Cumulative loan loss provision coverage remained adequate at 82% of non-performing loans, an improvement from 72% recorded in the prior year and much higher than selected peers – NPF (40.1%), Microcred (35.4%) and Accion (67.5%). When we include regulatory reserves, loan loss provision coverage will be over 100%.

The Bank's PAR to gross loans spiked further to 7.9%, based on unaudited financials for the nine months ended 30 September 2017. Agusto & Co. believes that PAR to gross loans may increase further in the near term, given the increasing pressures from the agriculture sector and the improving but weak economic fundamentals which continues to impair the performance of a number of many businesses.

Figure 4: Portfolio-at-Risk/Gross Loans

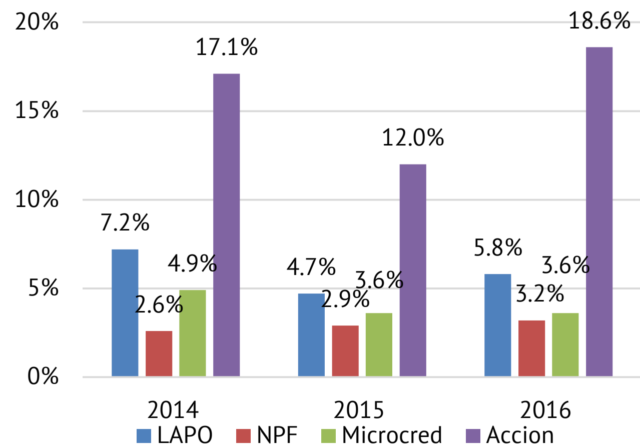
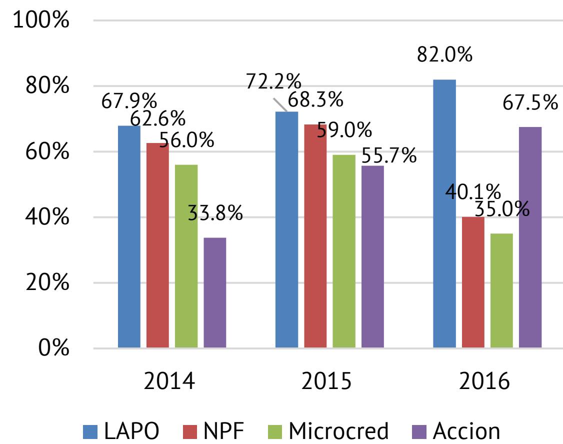


Figure 5: Loan Loss Provision/ Portfolio-at-Risk



Risk Management

LAPO Microfinance Bank Limited currently runs a decentralised risk management function overseen by the Board of Directors through the Board Risk Management Committee. The Board Risk Management Committee consists of three executive directors, inclusive of the Managing Director/CEO and a non-executive director. The Board has the responsibility to set and review the Bank's risk policies with regards to credit risk, market risk, reputational risk and operational risk. The Board also ensures the use of a risk management framework that identifies, measures and manages the Bank's risk position efficiently. The risk management division, headed by the Head, Risk Management, is responsible for implementing the Bank's risk management policies. The head of risk management ensures that weekly and quarterly reports are made to the Management Risk Management Committee and the Board Risk Management Committee respectively.

The Bank's risk management function is split into two units – risk management and credit management & loan recovery. The risk management team is responsible for handling the Bank's exposure to operational and reputational risk while credit management & loan recovery manages credit risk. LAPO's treasury unit oversees market risk management.

The Bank's decentralised risk management structure provides each branch with an independent ability to originate loans as well as manage other risk exposures including operational risk. LAPO currently runs a three-branch structure:

- Regular branches – staffed with client support officers (CSOs), branch manager as well as other support staff. Regular branches only administer group loan services.
- Mega branches – staffed with client support officers, an internal control officer, head of operations, assistant branch manager and a branch manager. The services at mega branches include loan administration and cash disbursements.

- Super branches – equipped with more staff in comparison to mega branches, make up the highest composition of LAPO's branch network.

Credit Risk

The loan origination process for all LAPO Microfinance Bank loans, which include individual, group and SME loans, is initiated at the branches. This is done to ensure the Client Support Officers closely monitor their loan portfolios. Individual and SME clients are reached through walk-ins and sales outreach. LAPO's group loans are extended to self-selected groups, with a maximum of sixty members. LAPO permits a maximum forty concurrent loan applications per group. If the maximum number of eligible loan applications is surpassed, LAPO requires the constitution of a new group.

The loan origination process at LAPO begins with the submission of an application form by the client, supported by some form of guarantee which may include personal guarantees, inventory of non-perishable goods and post-dated cheques. Following receipt of the loan application from the client, the CSO carries out preliminary loan evaluations prior to seeking approvals from either the branch credit committee or the management credit committee. Consumer loans, which include individual and group loans are approved by the branch credit committee[1] while SME loans are approved by the management credit committee at the head office, following a review by the credit management & recovery department.

The CSO's loan evaluation process includes:

- Verification of loan documentation, including KYC documentations, which are also verified by the branch's internal control officer
- A review of the repayment capacity of the borrower, which includes the use of credit bureaus for background checks, financial statement analysis[2] and valuation of inventory
- Verification of loan application's supporting documents such as title documents for housing loans
- Physical meeting with the loan applicant and guarantors – supported by the branch manager, area inspector or any member of the branch credit committee

Disbursements are made once all conditions precedent to draw down have been met. LAPO's housing loans are disbursed in tranches of ₦1 million, due to the higher facility amounts in comparison to individual, group and SME loans.

LAPO's core banking application; Orbit-R, is used to generate daily loan portfolio monitoring reports. These reports are generated by the CSOs and reviewed by the branch manager. LAPO's credit management & recovery department at the head office also carries out a daily assessment of the Bank's loan portfolio. The credit management & recovery unit at the head office has overall oversight on loan monitoring.

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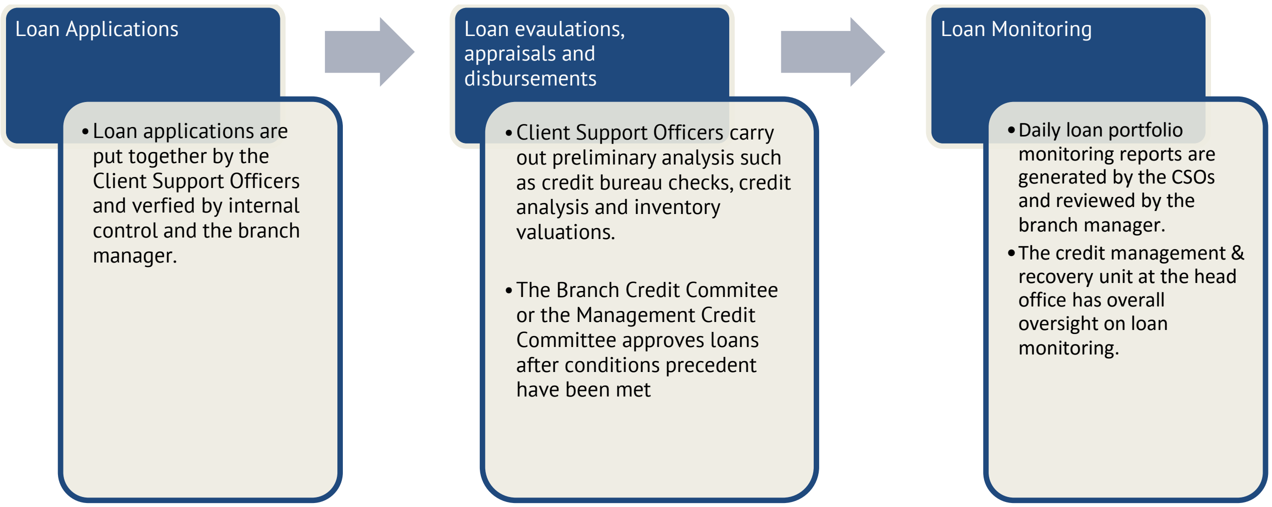
[1] The branch credit committee consists of the branch manager, assistant branch manager, internal control officer and the area inspector.
[2] LAPO has recently reviewed its loan evaluation process for SME loans to include the use of a credit appraisal application.

Figure 6: Loan Origination, Approval and Monitoring Process



Market Risk

The Bank's possible exposure to market risk is managed by the Treasury unit. LAPO's Treasury monitors the Bank's assets and liabilities by conducting a gap analysis to prevent mismatches that could emanate from interest rate changes as well as liquidity requirements. The Bank is currently reducing foreign exchange borrowings, thus, we expect exposure to foreign currency risk to be minimal.

Operational Risk

Operational risk issues are managed by the risk management and internal control. The Bank has at least one internal control officer at each branch, who ensures daily reconciliations are carried out. To also reduce the risk of theft and fraud, LAPO has ultraviolet technology at its branches. LAPO Microfinance Bank maintains an off-site archive, which enables the retention of data for up to six years.

Agusto & Co. considers the Bank's risk management practices to be adequate. However, as the business expands to include a number of non-traditional microfinance facilities such as housing loans, we believe that better risk management processes will be required to forestall additional increases in impaired loans.

EARNINGS AND PERFORMANCE

LAPO Microfinance Bank earnings include interest income from loans and advances, credit-related fees, commissions and other ancillary income. During the 2016 financial year, the Bank's net earnings increased by 24% to ₦23.1 billion, primarily due to a 15% growth in loans. Net revenue from funds remains the main source of earnings, remaining stable at 99% of net earnings.

Despite a 37% increase in interest income, LAPO's net interest margin (NIM) remained stable at 89.6%. NIM was impacted by a simultaneous rise in interest expense and loan charge-offs. Interest expense increased by 35% to ₦2.7 billion, largely due to the Naira devaluation impact on LAPO's foreign currency borrowings. During the 2016 financial year, 3.6% of interest income (₦964 million) was charged to the loan loss provision account, reflecting the deteriorating asset quality (2015: recoveries of ₦175 million). Nonetheless, LAPO's NIM compared favourably to selected peers - NPF (88.8%) and Microcred (83.3%), except Accion (92.2%).

The Bank's total operating expenses trended upwards in the review period - growing by 22% to ₦16.4 billion, largely due to increases in staff costs, travel expenses as well as repairs and maintenance. Staff costs, which remains the highest component of operating expenses (50%), increased by 20% on account of the recruitment of new staff, staff promotions and payment of bonuses. Travel expenses as well as repairs and maintenance increases were due to LAPO's branch expansion, with 47 additional branches opened during the review period. Despite this, the Bank's cost-to-income ratio (CIR) improved marginally to 71.5% (2015: 72.5%), slightly above LAPO's internal benchmark of 70%.

Figure 7: Breakdown of Operating Expenses

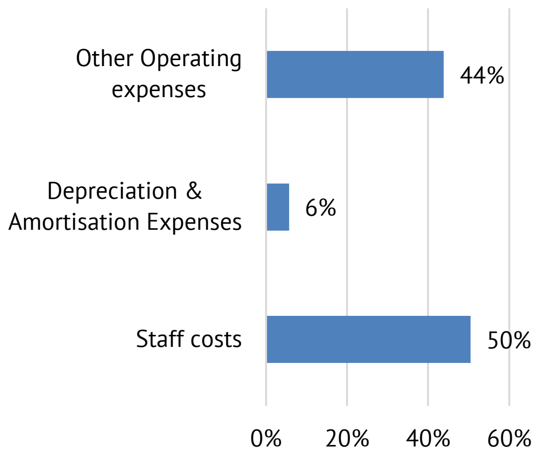
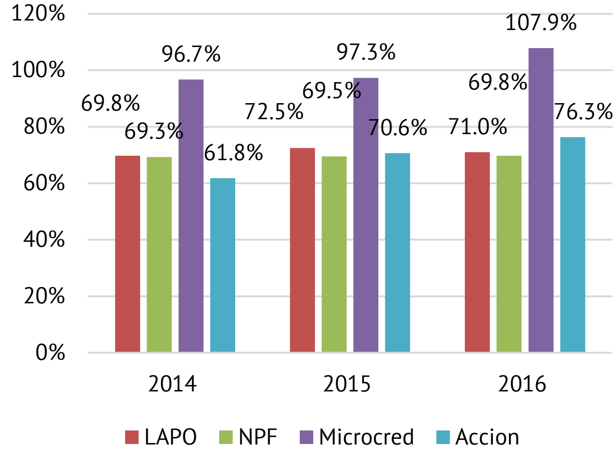


Figure 8: Cost-to-Income Ratio



LAPO Microfinance Bank's profitability continued on an upward trajectory, with pre-tax profit growing by 28% to ₦6.7 billion in the 2016 financial year. Subsequently, profitability indicators; pre-tax return on average assets (ROA) and pre-tax return on average equity (ROE) improved to 11.7% and 56.3% respectively, from 10.6% and 53.5% in the prior year. The Bank's profitability indicators stood well above key peers, including NPF, Microcred and Accion.

Figure 9: Pre-tax return on average assets (ROA)

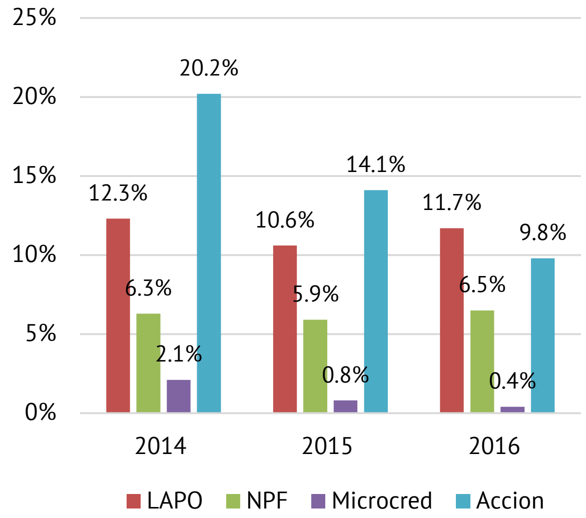
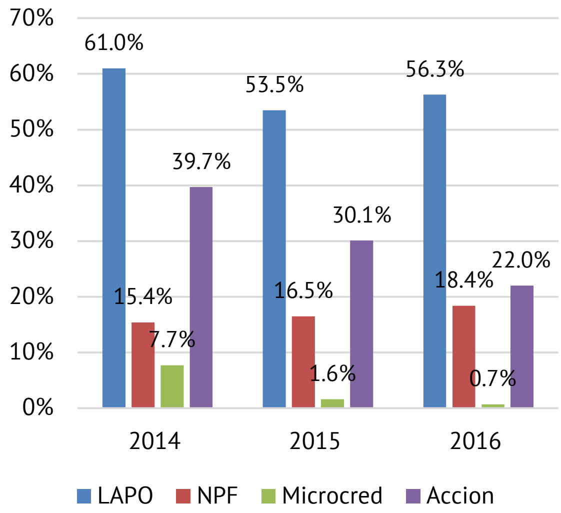


Figure 10: Pre-tax return on average equity (ROE)



The Bank's cost-to-income ratio deteriorated to 74.8% during the nine months ended 30 September 2017. Subsequently, profitability declined, with annualised pre-tax ROA and ROE of 9.8% and 43.1% respectively. We believe LAPO's profitability will dip further in the near term, on account of rising costs emanating from business expansion and the increasing volume of impaired loans. Nonetheless, we believe profitability will remain good and well-above the microfinance industry average.

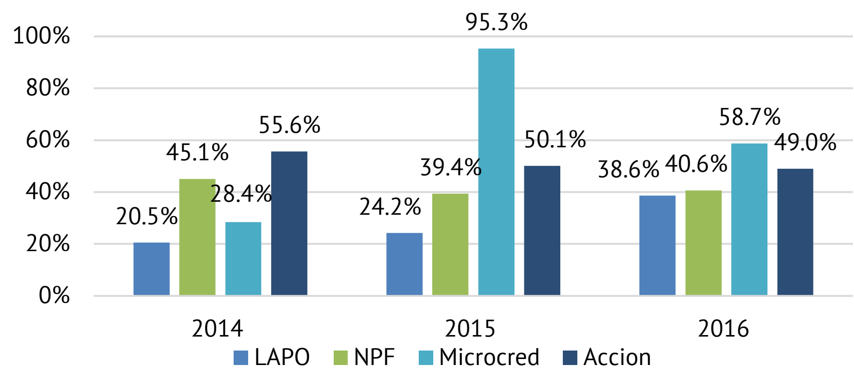
CAPITAL & LEVERAGE

As at 31 December 2016, LAPO's shareholders' fund stood at ₦13.6 billion, which represents a 25% year-on-year growth, on the back of higher earnings retention. The Bank's core capital remained well above the regulatory minimum of ₦2 billion for national microfinance banks operating in Nigeria.

The Bank's capital adequacy ratio (CAR) computed as adjusted capital to risk weighted assets, was good at 38.6% as at 31 December 2016 (FY2015: 24.2%). This stood well above the regulatory benchmark of 10% prescribed for national microfinance institutions operating in Nigeria, but below that of selected peers – NPF (40.6%), Microcred (58.7%) and Accion (49.0%). Subsequent to year-end, CAR remained adequate at 42.8% as at 30 September 2017.

In our opinion, LAPO Microfinance Bank's capitalisation is good for current business risks and we expect good accretion in retained earnings to support capital in the near term.

Figure 11: Capital Adequacy Ratio



LIQUIDITY & FUNDING

LAPO Microfinance Bank is primarily funded by equity, low-cost customer deposits and interest bearing borrowings from local and international financial institutions - including Development Finance Institutions (DFIs) such as Bank of Industry and African Development Bank (AfDB). The Bank's deposit generation strategy particularly focuses on low-income individuals & households, small-scale businesses and more recently, corporate institutions.

Deposit liabilities increased by 7.1% to ₦27.7 billion as at 31 December 2016, funding 44.2% of total assets. The growth in the deposit base resulted from a 5% rise in savings deposits to ₦25.8 billion. Deposit liabilities were also supported by a 46% growth in tenured deposits to ₦1.8 billion - as LAPO increasingly sought wholesale funds from corporate institutions. Nonetheless, saving deposits constituted the bulk of the Bank's total deposit liabilities (93.3%) while the more expensive tenured deposits accounted for 6.7% as at the same date (2015: 3.9%). LAPO's depositor base is well-diversified, with the top 20 depositors accounting for a meagre 1% of total deposit liabilities as at 31 December 2016.

Agusto & Co. believes that LAPO's deposit liability base will remain skewed towards savings deposits, given the vast pool of low-income clients, who typically run savings accounts. The Bank notes that at least 90% of these savings deposits are stable. We also expect the growth in deposit liabilities to be supported by the ongoing branch expansion.

Figure 12: LAPO's Funding Base

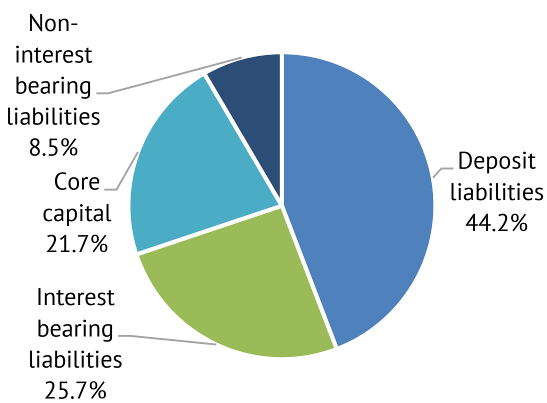
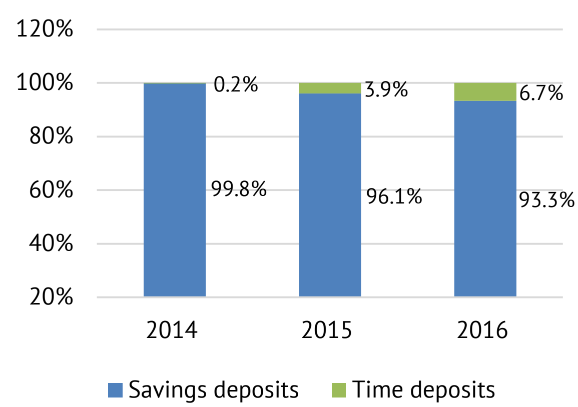


Figure 13: Breakdown of Deposit Liabilities



As at FYE 2016, LAPO's total borrowings stood at ₦16.1 billion, representing a 34% growth over the prior year. This was attributable to borrowings from the CBN and a number of development financial institutions, which collectively increased to 26% of total borrowings as at FYE 2016 (2015: 2.4%). These borrowings provide adequate support to the Bank's asset and liability management.

As at FYE 2016, foreign currency borrowings accounted for 46% of LAPO's total borrowings but reduced to 26% as at 30 September 2017. These borrowings are indexed to the Naira and expected to be fully paid down by 2018. In an effort to reduce exposure to foreign exchange risk, LAPO intends to diversify its funding base by accessing the domestic debt market. LAPO Microfinance Bank has disclosed plans to issue a bond in the first half of 2018, which will constitute the second series of a ₦20 billion debt issuance programme. LAPO raised a total of ₦3.15 billion in the first series.

LAPO's funding mix translated to a weighted average cost of funds (WACF) of 7.1%, which represents a slight increase from the prior year (2015: 6%). This was largely due to the Naira devaluation impact on LAPO's foreign currency borrowings (interest expense grew by 35% to ₦2.7 billion in 2016). Subsequent to year end, WACF had dipped to 6.52% for the nine months ended 30 September 2017. The drop in WACF reflects the reduced dependency on foreign currency loans and the use of CBN and DFI financing, which are typically priced at single digits. Given the lower cost of local currency borrowings compared to foreign currency borrowings, WACF may dip slightly if the proposed bond issuance is fully subscribed.

Table 3: Foreign Currency Borrowings

Lender	Maturing	Amortised value (₦'000) 31 Dec 2017	% of Total Borrowings	Amortised value (₦'000) 30 Sep 2017	% of Total Borrowings
Incofin CVSO/Impulse Loan	2017	669,240	4%	135,211	3%
Responsability	2017	2,224,837	13%	2,084,286	49%
Symbiotics	2017	1,904,074	18%	946,750	22%
Blue Orchard	2018	1,768,555	11%	1,086,603	26%
Total		**6,566,706**	**46%**	**4,252,850**	**28%**

The Bank's liquidity ratio (liquid assets to total deposit liabilities) stood at 35.2%, above the regulatory minimum of 20% for microfinance banks. As at FYE 2016, LAPO's loan to deposit ratio (after deducting loans funded from free capital and foreign currency borrowings) remained just within the regulatory benchmark of 80%.

Agusto & Co. considers LAPO's funding profile to be good.

OWNERSHIP, MANAGEMENT & STAFF

LAPO Microfinance Bank Limited is a privately owned microfinance bank. Subsequent to obtaining the microfinance bank licence in 2010, the Bank has gradually evolved to be one of the top microfinance banks in Nigeria. The Bank is owned by two major shareholders; LAPO NGO and Dr. Godwin Ehigiamusoe, who collectively account for 97.2% of the Bank's equity.

LAPO's Board of Directors currently comprises nine members – three executive directors and six non-executive directors (including one independent director). The Board of Directors has five committees:

- Board Risk Management Committee
- Board Audit Committee
- Board Finance and General Purpose Committee
- Board Environment, Social and Governance Committee

Dr. Godwin Ehigiamusoe is LAPO's Managing Director/Chief Executive Officer and is supported by six qualified and experienced senior management employees.

LAPO's staff strength increased significantly in the period under review, in line with the expansion in the Bank's branch network. LAPO employed an average of 6,392 employees during the review period (FY2015: 5,886 employees). Managerial staff accounted for 0.5%, while non-managerial staff (senior and junior staff), accounted for 99.5% of the Bank's workforce in 2016. LAPO's personnel expenses amounted to ₦8.3 billion, accounting for 50% of total operating expenses (2015: ₦6.6 billon and 52% of total operating expenses). Staff cost per employee grew by 18% year-on-year due to the recruitment of new staff, payment of bonuses and staff promotions.

Staff productivity measured in net earnings per staff improved to ₦3.6 billion (2015: ₦3 million) while staff cost per employee inched up to ₦1.3 million (2015: ₦1.1 million). Net earnings per staff remained sufficient to cover staff costs per staff approximately 2.8 times and compared favourably to the selected peers.

We consider LAPO's management team to be well-experienced while staff productivity is good.

Table 4: Staff Productivity Indicators

Indicators	LAPO FY 2015	LAPO FY 2016	NPF	Microcred	Accion
Average number of employees	5,886	6,392	284	293	884
Staff cost per employee	₦1.1 million	₦1.3 million	₦3.5 million	₦1.6 million	₦1.3 million
Net earnings per employee	₦3.0 million	₦3.6 million	₦9.4 million	₦4.2 million	₦3.3 million
Net earnings to staff cost	2.7 times	2.8 times	2.7 times	2.6 times	2.5 times

OUTLOOK

LAPO Microfinance Bank Limited's market leadership has been supported by significant investments in technology, branch expansion, human capacity development as well as product & service diversification. The Bank has recently concluded its 2013-2017 strategy and expects to adopt similar growth pillars in the coming years.

In 2016, LAPO launched the agent banking service, which is supported by financial technology for the over 200 agent bankers. The Bank's network has also been buoyed with the opening of 47 new branches in the 2016 financial year and an additional 29 in 2017. The widening network has also aided a more diversified product base, with a growing focus on other key sectors other than trade and commerce. LAPO was not completely immune to the challenges in the business environment as asset quality came under pressure in 2016. In our opinion, the adoption of more conservative and proactive risk management practices is imperative, given the new specialised loans to cyclical sectors such as agriculture and housing.

Going forward, the Bank's key business focus will be to exploit new markets, including rural and semi-urban areas, increase SME financing (within a cap of 10% of gross loans), improve technology and maintain a well-diversified funding base to include more domestic borrowings.

In our view, profitability and asset quality are likely to remain under pressure as business expands, in the presence of cost pressures and the need for better loan remedial management. We believe the Bank's capitalisation would remain adequate to support business risks. We also expect the liquidity & funding profile to remain satisfactory – supported by the increasing customer base and access to wholesale funding.

We hereby attach a **stable** outlook to the rating of LAPO Microfinance Bank Limited.

FINANCIAL SUMMARY

BALANCE SHEET AS AT	31-Dec-16		31-Dec-15		31-Dec-14	
	=N='000		=N='000		=N='000	
ASSETS						
Cash & equivalents	226,524	0.4%	84,833	0.2%	272,661	0.7%
Government securities	2,178,354	3.5%	1,334,877	2.5%	1,042,338	2.6%
Stabilisation securities		0.9%		0.6%		0.4%
Quoted investments						
Money market placements	588,554	0.9%	303,7614	0.6%	167,276	0.4%
LIQUID ASSETS	2,993,432	5.71%	1,723,471	3.9%	1,482,275	4.2%
Balances with Nigerian Banks	6,737,440	10.7%	5,024,634	9.6%	3,301,468	8.3%
Balances with banks outside Nigeria						
TOTAL PLACEMENTS	6,737,440	10.74%	5,024,634	9.6%	3,301,468	8.3%
Direct loans and advances - Gross	52,326,870	83.4%	44,455,587	84.8%	34,335,371	86.6%
Less: Cumulative loan loss provision	(2,471,240)	-3.9%	(1,503,750)	-2.9%	(1,606,306)	-4.1%
Direct loans & advances - net	49,855,630	79.5%	42,951,837	82.0%	32,729,065	82.6%
Advances under finance leases - net						
TOTAL LOANS - NET	49,855,630	79.49%	42,951,837	82.0%	32,729,065	82.6%
Interest receivable						
Interest paid in advance						
Other prepayments	648,712	1.0%	478,261	0.9%	276,517	0.7%
Tax recoverable						
Other accounts receivable	211,669	0.3%	240,016	0.5%	106,173	0.3%
Deferred losses						
TOTAL OTHER ASSETS	860,381	1.37%	718,277	1.4%	382,690	1.0%
Restricted funds						
Unconsolidated subsidiaries & associates						
Other long-term investments						
TOTAL OTHER LONG-TERM ASSETS						
Fixed assets under operating leases						
Property, plant & equipment - for own use	2,021,898	3.2%	1,546,852	3.0%	1,187,626	3.0%
Goodwill & other intangible assets	252,401	0.4%	433,822	0.8%	545,109	1.4%
TOTAL FIXED ASSETS & INTANGIBLES	2,274,299	3.63%	1,980,674	3.8%	1,732,735	4.4%
TOTAL ASSETS	**62,721,182**	**100.0%**	**52,398,893**	**100.0%**	**39,628,233**	**100.0%**
		19.70%		32.23%		43.70%
Acceptances & direct credit substitutes						
Guarantees, bonds e.t.c.						
Short-term self-liquidating contingencies						
TOTAL CONTINGENT ASSETS						
TOTAL ASSETS & CONTINGENTS	**62,721,182**	**100.0%**	**52,398,893**	**100.0%**	**39,628,233**	**100.0%**

BALANCE SHEET AS AT	31-Dec-16		31-Dec-15		31-Dec-14	
	=N='000		=N='000		=N='000	
CAPITAL & LIABILITIES						
Share capital	1,994,627	3.2%	1,985,256	3.8%	1,959,610	4.9%
Share premium						
Statutory reserve	3,482,006	5.6%	2,910,332	5.6%	2,498,949	6.3%
Exchange difference reserve						
Irredeemable preference shares						
Other non-distributable reserves						
Revenue reserve	8,140,347	13.0%	5,356,420	10.2%	3,456,547	8.7%
TIER 1 CAPITAL (CORE CAPITAL)	13,616,980	21.7%	10,252,008	19.6%	7,915,106	20.0%
		32.8%		29.5%		
Revaluation surplus						
Redeemable preference shares						
Other long-term borrowings	9,580,263	15.3%	2,345,945	4.5%	344,222	0.9%
TIER 2 CAPITAL	9,580,263	15.3%	2,345,945	4.5%	344,222	0.9%
Other Long term Foreign borrowings	6,566,706	10.5%	8,244,670	15.7%	6,703,750	16.9%
Demand deposits						
Savings deposits	25,828,954	41.2%	24,703,603	47.1%	20,321,406	51.3%
Time deposits	1,843,265	2.9%	1,002,180	1.9%	38,610	0.1%
Inter-bank takings						
TOTAL DEPOSIT LIABILITIES - LCY	27,672,219	54.6%	25,705,783	64.8%	20,360,016	68.3%
Customers' foreign currency balances						
TOTAL DEPOSIT LIABILITIES	27,672,219	54.6%	25,705,783	64.8%	20,360,016	68.3%
Interest payable			57,087	0.1%	138,168	0.3%
Unearned interest & discounts						
Taxation payable - deferred	122,242	0.2%	101,281	0.2%	61,220	0.2%
Taxation payable - current	3,291,163	5.2%	2,095,495	4.0%	1,966,163	5.0%
Dividend payable					532,357	1.3%
Other accounts payable	1,871,609	3.0%	3,596,624	6.9%	1,607,231	4.1%
TOTAL OTHER LIABILITIES	5,285,014	8.4%	5,850,487	11.2%	4,305,139	10.9%
TOTAL CAPITAL & LIABILITIES	**62,721,182**	**100.0%**	**52,398,893**	**100.0%**	**39,628,233**	**100.0%**
Acceptances & direct credit substitutes						
Guarantees, bonds etc.						
Short-term self-liquidating contingencies						
TOTAL CONTINGENT LIABILITIES						
TOTAL CAPITAL, LIABILITIES & CONTINGENTS	**62,721,182**	**100.0%**	**52,398,893**	**100.0%**	**39,628,233**	**100.0%**

INCOME STATEMENT FOR THE YEAR ENDED	31-Dec-16		31-Dec-15		31-Dec-14	
	=N='000		=N='000		=N='000	
Interest income	26,669,311	99.2%	19,408,496	99.2%	16,503,804	99.7%
Interest expense	(2,767,416)	-10.3%	(2,052,841)	-10.5%	(1,550,105)	-9.4%
Loan loss expense	(963,985)	-3.6%	174,570	0.9%	(1,279,525)	-7.7%
NET REVENUE FROM FUNDS	22,937,910	85.3%	17,530,225	89.6%	13,674,174	82.6%
FOREIGN EXCHANGE			31,273	0.2%	4,995	0.0%
COMMISSIONS	3,839	0.0%	14,336	0.1%	(7,962)	0.0%
FEES & OTHER INCOME	207,467	0.8%	106,953	0.5%	52,886	0.3%
NET EARNINGS	23,149,216	86.1%	17,682,787	90.4%	13,724,093	82.9%
STAFF COSTS	(8,291,467)	-30.8%	(6,624,042)	-33.9%	(5,191,077)	-31.4%
DEPRECIATION EXPENSE	(933,120)	-3.5%	(723,458)	-3.7%	(518,304)	-3.1%
OTHER OPERATING EXPENSES	(7,207,431)	-26.8%	(5,472,150)	-28.0%	(3,866,060)	-23.4%
OPERATING EXPENSES	(16,432,018)	-61.1%	(12,819,650)	-65.5%	(9,575,441)	-57.8%
PROFIT (LOSS) BEFORE TAXATION	6,717,198	25.0%	4,863,137	24.9%	4,148,652	25.1%
TAX (EXPENSE) BENEFIT	(2,170,443)	-8.1%	(1,572,076)	-8.0%	(1,340,413)	-8.1%
		38.1%		17.2%		
PROFIT (LOSS) AFTER TAXATION	4,546,755	55.0%	3,291,061	34.0%	2,808,239	17.0%
NON-OPERATING INCOME (EXPENSE) - NET						
STATUTORY RESERVE			(411,383)	-2.1%	(336,343)	-2.0%
CAPITAL REDEMPTION						
PROPOSED DIVIDEND	(1,191,154)	-4.4%	(979,805)	-5.0%	(600,097)	-3.6%
SCRIP ISSUES					(539,879)	-3.3%
OTHER APPROPRIATIONS	(571,674)	-2.1%				
RETAINED PROFIT	2,783,927	48.5%	1,899,873	26.9%	1,331,920	8.0%
RETAINED PROFIT B/FWD	5,356,420		3,456,547		2,124,627	
RETAINED PROFIT C/FWD	8,140,347		5,356,420		3,456,547	
Proof						
GROSS EARNINGS	26,880,617	100.0%	19,561,058	100.0%	16,553,723	100.0%

KEY RATIOS	31-Dec-16	31-Dec-15	31-Dec-14
PROFITABILITY RATIOS			
Net interest margin	89.6%	89.4%	90.6%
Loan loss expense/Interest income	3.6%		7.8%
Operating expenses/Net earnings	71.0%	72.5%	69.8%
Return on average assets (pre-tax)	11.7%	10.6%	12.3%
Return on risk weighted assets (average)	12.2%	11.1%	13.0%
Return on average equity (pre-tax)	56.3%	53.5%	61.0%
Gross earnings/Total assets & contingents (average)	46.7%	42.5%	49.3%
EFFICIENCY INDICATORS			
Operating expenses/average loan portfolio	35%	34%	34%
Adjusted operating expenses/average loan portfolio	33%	32%	32%
Personnel expenses/average loan portfolio	18%	18%	19%
LIQUIDITY RATIOS			
Total loans - net/Total lcy deposits	80.8%	93.7%	95.8%
Liquid assets/Total lcy deposits	35.2%	26.3%	23.5%
Demand deposits/Total lcy deposits			
Savings deposits/Total lcy deposits	93.3%	96.1%	99.8%
Time deposits/Total lcy deposits	6.7%	3.9%	0.2%
ASSET QUALITY RATIOS			
PERFORMING LOANS	49,314,920	42,373,580	30,363,190
NON-PERFORMING LOANS	3,011,950	2,082,007	2,365,875
Non-performing loans/Total loans - Gross	5.8%	4.7%	6.9%
Loan loss provision/Total loans - Gross	4.7%	3.4%	4.7%
Loan loss provision/Non-performing loans	82.0%	72.2%	67.9%
Write-offs/Average loan portfolio	0.04%	0.03%	
Adjusted write-offs/Average loan portfolio	0%	0%	
Deterioration ratio	12%	-2%	19%
CAPITAL ADEQUACY RATIOS			
Adjusted capital/risk weighted assets	38.6%	24.2%	20.5%
Tier 1 capital/Adjusted capital	58.2%	80.7%	95.5%
Adjusted capital/Total loans - net	3.73	4.37	4.44
EARNINGS BREAKDOWN			
Net revenue from funds	99.1%	99.1%	99.6%
Foreign exchange		0.2%	0.0%
Commissions	0.0%	0.1%	-0.1%
Fees & other income	0.9%	0.6%	0.4%
STAFF INFORMATION			
Average number of employees	6,392	5,886	4,231
Staff cost per employee (N'000)	1,297	1,125	1,227
Net earnings per staff (N'000)	3,622	3,004	3,244
Staff cost/Net earnings	35.8%	37.5%	37.8%
Staff costs/Operating expenses	50.5%	51.7%	54.2%

RATING DEFINITIONS

Aaa	A financial institution of impeccable financial condition and overwhelming capacity to meet obligations as and when they fall due. Adverse changes in the environment (macro-economic, political and regulatory) are unlikely to lead to deterioration in financial condition or an impairment of the ability to meet its obligations as and when they fall due. In our opinion, regulatory and/or shareholder support will be obtained, if required.
Aa	A financial institution of very good financial condition and strong capacity to meet its obligations as and when they fall due. Adverse changes in the environment (macro-economic, political and regulatory) will result in a slight increase the risk attributable to an exposure to this financial institution. However, financial condition and ability to meet obligations as and when they fall due should remain strong. Although regulatory support is not assured, shareholder support will be obtained, if required.
A	A financial institution of good financial condition and strong capacity to meet its obligations. Adverse changes in the environment (macro-economic, political and regulatory) will result in a medium increase in the risk attributable to an exposure to this financial institution. However, financial condition and ability to meet obligations as and when they fall due should remain largely unchanged. In our opinion, shareholder support should be obtainable, if required.
Bbb	A financial institution of satisfactory financial condition and adequate capacity to meet its obligations as and when they fall due. It may have one major weakness which, if addressed, should not impair its ability to meet obligations as and when due. Adverse changes in the environment (macro-economic, political and regulatory) will result in a medium increase in the risk attributable to an exposure to this financial institution.
BB	Financial condition is satisfactory and ability to meet obligations as and when they fall due exists. May have one or more major weaknesses. Adverse changes in the environment (macro-economic, political and regulatory) will increase risk significantly.
B	Financial condition is weak but obligations are still being met as and when they fall due. Has more than one major weakness and may require external support, which, in our opinion, is not assured. Adverse changes in the environment (macro-economic, political and regulatory) will increase risk significantly.
C	Financial condition is very weak. Net worth is likely to be negative and obligations may already be in default.
D	In default.

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